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October 10, 1997

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Mr. William Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

Re: Notice Of Ex Parte Presentation In IB Docket No. 97-142

Dear Mr. Caton:

On behalf of Cable & Wireless plc and Cable & Wireless Inc., we are submitting the attached document on the record in the above-referenced proceeding. We previously advised the International Bureau of the preparation of this document, and portions of this document reflect discussions held with the International Bureau earlier this week.

Respectfully submitted,

JM Griffin

Robert J. Aamoth
Joan M. Griffin

cc: Diane Cornell
Regina Keeney
Adam Krinsky
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Ex Parte Presentation

IB Docket No. 97-142
Rules and Policies on Foreign Participation in the U.S. Telecommunications Market

Cable & Wireless, Inc.
Cable & Wireless plc.

October 10, 1997

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EX PARTE PRESENTATION
BY CABLE & WIRELESS PLC AND CABLE & WIRELESS, INC.

THE FCC SHOULD NOT PROHIBIT U.S. CARRIERS WITH FOREIGN AFFILIATES FROM SERVING AFFILIATED ROUTES ON A SWITCHED RESALE BASIS IF THE FOREIGN AFFILIATE DOES NOT ACCEPT BENCHMARK SETTLEMENT RATES

I. THE FCC SHOULD EVALUATE AT&T'S PROPOSAL BASED ON MARKET REALITY.

A. AT&T's Theory. AT&T asserts that the resale Section 214 condition is necessary to prevent foreign carriers from entering the U.S. market on a resale basis and offering below-cost collection rates as a mechanism to stimulate settlement revenues. AT&T theorizes that the losses incurred by the U.S. resale affiliate would be more than offset by increased settlement revenues earned by the foreign affiliate.

B. Market Reality. The market reality is that the misconduct theorized by AT&T has never materialized. There has already been a lengthy market test of AT&T's theory, and that test has repudiated AT&T's theory.

(i) CWI has been providing international switched resale services on more than 20 affiliated routes for more than ten years. The settlement rates on all of those routes have been, and many still are, above the FCC's benchmark rates. Yet no one has provided any evidence or even alleged that CWI has engaged in below-cost pricing as a mechanism to stimulate settlement revenues. The fact that CWI is not offering service based on predatory pricing can be verified from CWI's tariffs.

(ii) Other U.S. carriers with foreign affiliates are also providing international resale services on routes where their foreign affiliate provides correspondent services. For example, BTNA was authorized to provide such services to the U.K. in 1994; AmericaTel, to Chile in 1994. See BT North America Inc., 9 FCC Rcd 6851 (1994); AmericaTel Corp., 9 FCC Rcd 3993 (1994). No one has proven or even alleged that any of these U.S. carriers have engaged in below-cost pricing as a mechanism to stimulate settlement revenues. AT&T alleged in opposing GTE Telecom's application for authority to provide international resale services to Venezuela and the Dominican Republic that GTE could conceivably engage in such behavior, but did not provide evidence that GTE had in fact done so through other subsidiaries. See GTE Telecom Inc., DA 96-1546, 1997 WL 523440, at ¶¶ 38-39 (rel. September 16, 1996).

(iii) If the problem theorized by AT&T were to occur, it would have occurred in the past when settlement rates were higher than they are today. The FCC's statistics demonstrate the extent to which settlement rates have declined steadily in the 1990s. The average per minute settlement owed for U.S.-billed calls dropped from \$.70 in 1990 to \$.48 in 1995. Over the same period, the average per minute settlement due for foreign-billed calls dropped from \$.60 to \$.29. See 1997 Trends in Telephone Service, F.C.C. Industry Analysis Div., at Table 50 (rel. March 28, 1997). AT&T is asking the FCC to adopt a remedy to address misconduct that has never occurred in the past and to do so today when the incentives for U.S. carriers with foreign affiliates to engage in misconduct are weaker than they have ever been.

C. Protectionism. It is obvious that AT&T's goal is not to prevent U.S. carriers with foreign affiliates from engaging in below-cost pricing in order to stimulate settlement revenues for their foreign affiliates. Rather, AT&T's goal is to make it as difficult as possible for U.S. carriers with foreign affiliates to compete in the U.S. market, and possibly to exclude many such carriers from the U.S. market altogether. As such, AT&T is attempting to substitute its own private interests for the public interest.

II. ADOPTING CONDITIONS ON SECTION 214 RESALE LICENSES WOULD UNDERMINE COMPETITION TO THE ULTIMATE DETRIMENT OF U.S. CONSUMERS.

A. The FCC's Goals. The Commission states in the NPRM that the primary goal of this proceeding is to advance the public interest by promoting effective competition. Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, Order and Notice of Proposed Rulemaking, 62 Fed. Reg. 32966 (1997), at ¶ 25, (rel. June 4, 1997) ("Foreign Participation Notice"). Effective competition promotes opportunities for U.S. consumers to choose among multiple suppliers based on innovative offerings, service quality and efficiency, and price competitiveness.

Adoption of the resale Section 214 condition would directly conflict with the FCC's stated goal, and statutory mandate, to promote competition and U.S. consumer interests. Those interests are clearly at stake here, given the evidence, and the FCC's acknowledgement, that the U.S. international services market is far from competitive. See Regulation of International Accounting Rates, Phase II, Fourth Report and Order, 11 FCC Rcd 20063, 20066 (1996) ("there is significant evidence that the current market structure for international services in the U.S. is not producing sufficient competition"); AT&T Comments filed July 9, 1997 in Foreign Participation Notice, Lehr Affidavit at 6 ("the markets for [U.S.] local and international services are not adequately competitive") ("AT&T Comments"); Declaration of Paul W. MacAvoy, filed March 31, 1997 in IB Docket No. 96-261, at 2-3 ("empirical evidence indicates that [U.S.] outbound international tariff rates are not competitive"); Merger of MCI Communications Corporation and British Telecommunications plc, GN Docket No. 96-245, Memorandum Opinion and Order, at ¶ 55, n. 91 (rel. Sept. 24, 1997) (margins on international services are "generally...high") ("BT/MCI"). U.S. consumers will have less choice if U.S. carriers with foreign affiliates are excluded from the market.

B. Impact on Consumers and Competition. The proposed condition will have a significant adverse impact on consumers by affecting existing and potential competition in the U.S. and foreign markets. Because the FCC has already conditioned facilities-based licenses, placing a similar condition on resale licenses is tantamount to revoking the license altogether, thereby forcing the carrier to exit the market. This would be particularly harmful from a competitive perspective in serving business customers, since these customers want and need ubiquitous global service from a single carrier. Moreover, the Commission has previously recognized the competitive value of being a full-service carrier in the U.S. market. See Market Entry and Regulation of Foreign-Affiliated Entities, Report and Order, 11 FCC Rcd 3873, 3886 (1995) ("Foreign Carrier Market Entry Order"); BT/MCI at ¶ 55, n.91. As a result of being unable to serve an affiliated route, a U.S. carrier would lose existing customers and would be unable to grow its customer base. In addition, the U.S. carrier would incur termination costs with equipment and service vendors as well as with customers as it is forced to scale back its operations. Indeed, most resale carriers have agreements with their underlying U.S. carriers which require volume commitments for international traffic. Foreign-affiliated U.S. carriers will be forced to pay penalties for their inability to continue delivering traffic. This will result in even greater costs for any remaining customers. The FCC historically has considered harm to competitors as a factor in its public interest analysis. E.g., Access Charge Reform, First Report and Order, 62 Fed. Reg. 31868 (1997), at ¶ 166 (rel. May 16, 1997) (permitting ILECs to continue collecting above-cost interstate access rates to prevent harm to ILECs) ("Access Charge Reform"); Amendment of Part 69, Report and Order, 6 FCC Rcd 4524, 4534 (1991) (granting enhanced service providers exemption from paying access charges). The impact of the proposed condition on CWI provides a case on point. CWI serves nearly 80,000 customers in the U.S. Of these customers, nearly 50% made at least one call to a CWI-affiliated country in the last three months. The condition being considered by the FCC would effectively force CWI to discontinue service to several countries, resulting in a loss of hundreds of millions of dollars in revenue for the company. Many customers may now seek a new service carrier, possibly at more expensive rates with less attractive products and features.

It is not necessary for the Commission to revoke the resale authorization of a U.S. carrier with foreign affiliates in order for that carrier to be harmed by the proposed resale Section 214 condition. U.S. carriers with foreign affiliates will be harmed significantly simply by adoption of the condition. The Commission recognized in fONOROLA Reconsideration that license conditions on resale authorizations that require the immediate suspension of the authorization upon the occurrence of certain events place resellers at a competitive disadvantage by creating market and financial uncertainty and by hampering the availability of long term financing. The Commission found in this case that such conditions ultimately inhibit the entry of foreign carriers in the market and could discourage foreign administrations from opening their own markets to resale. fONOROLA Corp., Order on Reconsideration, 9 FCC Rcd 4066, 4069-70 (1994). The very existence of the condition will provide fodder for AT&T and others who will use the condition in their marketing efforts to convince potential customers that they should not take service from U.S. carriers with foreign affiliates, since these carriers may not be able to continue providing service on the route. Such circumstances will discourage new entry by foreign carriers into the U.S. market and new investment in existing U.S. carriers with foreign affiliates. It will also discourage U.S. carriers from investing in carriers overseas, since any such investment greater than 25 percent will trigger the condition. The FCC has recognized that U.S. consumers benefit from U.S. participation in competitive markets abroad. See Foreign Participation Notice at ¶ 27.

By discouraging and hindering the competitive efforts of U.S. carriers with foreign affiliates in this fashion, the proposed conditions would harm U.S. consumers. Since U.S. carriers with foreign affiliates would be discouraged from competing in the U.S. market, U.S. consumers would have fewer choices of carriers and services. For existing customers of U.S. carriers with foreign affiliates, the condition would generate substantial uncertainty, since it would create the possibility that the Commission would revoke the carrier's authorizations on certain routes. Were the Commission in fact to revoke a carrier's authorizations, it would be disruptive, inconvenient, and harmful for customers to be forced to make new arrangements with different carriers on precluded routes. Some customers would not be able to obtain the same services that they currently receive from other carriers. If equivalent services were available, customers might not be able to obtain similar terms and conditions for service, might be liable for new nonrecurring charges and additional service terms, or could lose the term and volume discounts they qualified for under their previous service arrangements. In other cases, customers could find it necessary to reconfigure CPE or spend funds on new equipment to obtain equivalent features and functions from their new service providers. The Commission has previously tailored its regulations to avoid harm to consumers. See e.g., Investigation of Special Access Tariffs of Local Exchange Carriers, Memorandum Opinion and Order, 8 FCC Rcd 4712, 4723 (1993) (temporary rate equalization plan adopted for converting access rates to uniform, cost-based rates to avoid customer rate shock); Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd 8961, 8974 (1995) (price caps protect customers from cross-subsidization, rapid rate increases, and predatory pricing); Access Charge Reform at ¶ 38 (subscriber line charges capped for primary residential and single-line business users to assure affordability of basic phone service).

C. Public Interest Test. The public interest cost of imposing the resale condition vastly exceeds the purely hypothetical competitive benefit envisioned by AT&T; the balance of the public interest is clearly on the side of continuing to permit resale. Certainly, not even AT&T can pretend that all foreign carriers with above-benchmark settlement rates who enter the U.S. market on a resale basis will engage in below-cost pricing. Yet AT&T is willing to preclude entry by any such carrier simply to guard against the mere possibility that one or a few of them might engage in a below-cost pricing scheme on a particular route. It is understandable why AT&T is eager to force out of the market those U.S. carriers with foreign affiliates who would engage in strong, lawful price competition. Clearly, there is considerable scope for price competition in the U.S. international services market, and it is in AT&T's best interests to stifle competition so as to maintain its margins. But there is no reason why the FCC should participate in AT&T's anti-competitive scheme to the detriment of U.S. competition and consumer interests.

At a minimum, in analyzing AT&T's proposal under the public interest standard, the FCC must take into account the lessened competition that a resale Section 214 condition would cause by excluding lawful competitive offerings of U.S. carriers with foreign affiliates from the U.S. market. As the Commission has recognized and AT&T effectively acknowledges, competition starts with resale; it allows carriers to enter the market and establish their brand presence with minimal financial risk. Foreign Carrier Market Entry Order, 11 FCC Rcd at 3886; See AT&T Comments at 31. Thus, precluding resale fundamentally alters the market entry dynamic and would seriously undercut achievement of the Commission's primary goal in this proceeding, i.e., promoting effective competition in the U.S. services market. Yet as is clear from the realities of the market, there is no countervailing public interest benefit to preventing U.S. carriers with foreign affiliates from participating in the U.S. international services market, since there is no history of these carriers engaging in anticompetitive conduct of the type alleged by AT&T.

III. THE FACT THAT THE FCC HAS IMPOSED A SIMILAR CONDITION ON FACILITIES-BASED SECTION 214 AUTHORIZATIONS DOES NOT NECESSITATE IMPOSING THE SAME CONDITIONS ON RESALE SECTION 214 AUTHORIZATIONS.

A. Facilities-Based Versus Resale. In the Settlement Rate Decision, the FCC imposed a benchmark compliance condition upon the facilities-based Section 214 authorizations of foreign-affiliated U.S. carriers on affiliated routes. See International Settlement Rates, Report and Order, IB Docket No. 96-261, 1997 WL 471711 (rel. August 18, 1997), at ¶ 231 ("Settlement Rate Decision"). The C&W companies believe this decision to be neither justified nor lawful. To impose similar conditions upon Section 214 resale authorizations would compound the error by being equally unlawful and even less justified. There are numerous reasons why the FCC should not impose such a condition upon facilities-based Section 214 authorizations. As shown below, these reasons apply with even greater force with respect to resale Section 214 authorizations.

B. Competitive Impact. The adverse impact upon competitive conditions in the U.S. international services market would be much greater for the resale Section 214 condition. By imposing the condition upon facilities-based authorizations, the FCC has made it more expensive for U.S. carriers with foreign affiliates to serve particular routes, by precluding them from directly purchasing their own facilities. For CWI, this decision has already had a significant impact. As noted previously, the resale condition would prevent carriers from continuing to serve their customers on particular routes, in effect forcing them to exit the market on that route and perhaps the overall market as well. Given the FCC's objective of reducing settlement rates to ensure lower collection rates for U.S. consumers, it makes no sense to force U.S. carriers with foreign affiliates to exit the market, thereby removing competitive pricing pressure on AT&T, when their foreign affiliates do not accept the benchmark rates.

C. Risk of Detection. It would be easier for the FCC and competing carriers to detect a below-cost pricing strategy by a resale carrier than by a facilities-based provider. One reason is that the FCC knows, or can readily find out, the wholesale rates that the resale carrier pays to its underlying facilities-based carrier. By contrast, the FCC and competing carriers may not have precise information on the underlying transmission costs of a facilities-based carrier. A second reason is that the resale carrier's underlying facilities-based carrier will have both the ability and incentive to monitor the resale carrier's pricing decisions and its traffic. The only costs incurred by the reseller that won't be known by its competitors are the reseller's variable retail costs, but even then AT&T would always be able to assume that the reseller's variable retail costs are no lower than AT&T's own variable retail costs. Thus, wholly apart from AT&T's proposed condition, a resale foreign-affiliated carrier will not engage in this misconduct because it knows that such misconduct would be detected immediately, as its underlying costs are readily discernable.

D. Incentive. A U.S. resale carrier with foreign affiliates has much less incentive to engage in a below-cost pricing scheme because it is much less likely such a scheme would be profitable. First, for the same volume of traffic, a resale carrier normally will have higher costs and lower margins than a facilities-based carrier serving the same route.

Second, a resale carrier does not qualify for return traffic from its foreign affiliate, whereas a facilities-based carrier would mitigate the losses incurred from the below-cost pricing strategy through the return traffic it would receive from its foreign affiliate. Therefore, a resale carrier would incur much higher losses to implement a below-cost pricing scheme, and therefore it is much less likely that a foreign carrier could put together a viable business plan under which increased settlement revenues would offset the losses incurred by the affiliated U.S. resale carrier.

E. Duration. Even if one assumes that a foreign-affiliated U.S. resale carrier could generate a sufficient increase in settlement revenues for its foreign affiliate to more than offset its losses from below-cost pricing in the U.S., that business plan could only last a very short time. The reason is that the increase in U.S.-billed traffic on the route would increase the net (or unit) settlement payments of the underlying facilities-based U.S. carrier. In response, the underlying U.S. facilities-based carrier would increase the wholesale rates that it was charging to the foreign-affiliated resale carrier, thereby increasing the reseller's losses and removing any net benefit from the below-cost scheme. Therefore, the below-cost pricing strategy would cause the resale carrier's wholesale rates to increase such that the strategy no longer made business sense. By contrast, a facilities-based carrier would not face this situation. Its underlying transmission costs would be stable or declining.

F. Lehr Affidavit. In support of its proposal to condition Section 214 authorizations on compliance with appropriate accounting rates, AT&T submits the affidavit of Professor Lehr ("Lehr Affidavit"). The C&W companies' analysis of the Lehr Affidavit is provided in the following section. Even if the Lehr Affidavit could be viewed as providing valid support for adoption of a facilities-based Section 214 condition -- which the C&W companies submit it cannot, as discussed below -- the Lehr Affidavit does not provide a credible basis for adopting a similar resale Section 214 condition. First, Lehr does not even attempt to analyze the harm to competition from excluding foreign-affiliated resale carriers from certain routes or from the market altogether. Second, Lehr does not assess the comparative risk of detection and its impact upon a carrier's incentive to engage in below-cost pricing. Third, Lehr assumes incorrectly that facilities-based and resale carriers would incur the exact same level of losses. Compare Lehr Exhibits 2 and 3 (assuming losses of $11,750 for each). Fourth, Lehr does not recognize that a facilities-based carrier, but not a resale carrier, could reduce its losses from below-cost pricing through return traffic. Fifth, Lehr does not take into account that a resale carrier's wholesale costs would increase as a direct consequence of the below-cost pricing strategy.

G. Conclusion. It simply is not credible to suggest that a foreign carrier would implement a below-cost resale pricing scheme as a means of maximizing settlement revenues when such a scheme is unlawful, easily detected, difficult to justify from a profit-loss standpoint, and even in the best-case scenario likely to generate profits only for a short period of time. The reason why no U.S. carriers with foreign affiliates have engaged in the misconduct which AT&T claims to fear is that no such carriers have the incentive or ability to engage in such misconduct as a rational business strategy.

IV. *THERE IS NO EMPIRICAL, LOGICAL OR POLICY BASIS FOR ADOPTING CONDITIONS ON RESALE SECTION 214 AUTHORIZATIONS.*

A. No Rational Basis. There is no basis for concluding that U.S. carriers with foreign affiliates have the incentive or ability to engage in below-cost pricing on an affiliated route in order to maximize the settlement revenues received by the foreign affiliate.

(i) It should be noted that while AT&T speculates that foreign carriers might have an incentive to subsidize entry into the U.S. or to raise rivals' costs of entering foreign markets (e.g., Lehr Affidavit at 13), such concerns have no discernible nexus to the proposed resale Section 214 condition. Any foreign entity with market power in any market presumably would be a "threat" to engage in such conduct under AT&T's thinking, regardless of whether it was affiliated with a foreign carrier on the route or its settlement rates satisfied the benchmark policies. The sole plausible basis for imposing a resale Section 214 condition would be to prevent foreign carriers from seeking to engage in below-cost pricing as a mechanism for maximizing settlement revenues. As demonstrated, there are ample market and regulatory disciplines to prevent such a strategy without imposing draconian market access restrictions.

(ii) AT&T's theory that carriers would deliberately incur losses in order to stimulate settlement revenues for their foreign affiliates is not only contrary to established marketplace behavior, it is counter-intuitive. E.g., Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 589 (1986) ("there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful"). No rational carrier would even consider such a plan unless it was certain to result in significant net profits for an extended period of time. AT&T has only attempted to show that it is theoretically possible to imagine a scenario in which a carrier could achieve small net profits by engaging in such conduct, and even that showing is riddled with analytical, empirical and logical errors (see Section IV.B below).

To the extent a foreign carrier has any interest at all in pricing its U.S. services to maximize settlement revenues, the only rational business strategy for a carrier would be to price just above its costs. Under that scenario, the resale affiliate would undercut AT&T's international calling rates while still earning reasonable profits as a U.S. carrier. By stimulating U.S.-outbound traffic, the reseller would increase settlement revenues for its foreign affiliate. The incremental gain of dropping the prices still further to be lower than its costs would be tiny in comparison to the enormous practical and legal risks that the carrier would assume by engaging in illegal pricing.

(iii) No carrier could hope to engage in a below-cost pricing scheme without immediate detection by U.S. carriers and the FCC. AT&T and other U.S. carriers have detailed information on their own costs, and any new carrier entering the U.S. international resale market is unlikely to have lower costs. Further, foreign carriers must tariff their rates with the FCC, thereby providing both competing carriers and the FCC with immediate information about their price levels. Therefore, both competing carriers and the FCC will know immediately if any carrier were to implement a below-cost pricing scheme in the U.S. market. Other U.S. carriers could pursue, and the FCC could initiate, appropriate regulatory or legal proceedings to investigate the resale carrier and stop any unlawful conduct. See 47 U.S.C. §§ 4(i), 204-05, 206-08, 211, 403, 501-04.

(iv) The FCC's proposed basic safeguards in the Foreign Participation Notice would supplement the ability of the FCC and competing carriers to closely monitor the pricing and other business activities of U.S. carriers with foreign affiliates. In particular, the FCC has proposed quarterly traffic and revenue reports that would permit virtually immediate detection of any below-cost pricing schemes initiated by U.S. carriers with foreign affiliates, as well as any traffic migration caused by the pricing practices of such carriers. Foreign Participation Notice, at ¶¶ 98-101. Given the mechanisms the Commission is putting into place to ensure reliable, early detection of misconduct by foreign-affiliated carriers, it is regulatory overkill for the FCC to impose resale Section 214 conditions on top of those safeguards.

(v) It is unreasonable to exclude carriers from the U.S. market in order to prevent them from engaging in conduct that is independently unlawful under U.S. laws. Even if a carrier believed that it could maximize net profits through a below-cost pricing scheme, it would not implement such a scheme because it would be in violation of U.S. laws and policies. First, below-cost pricing which is detrimental to competition is an unjust and unreasonable practice in violation of Section 201(b) of the Communications Act. 47 U.S.C. § 201(b). E.g., Competitive Carrier Rulemaking, 77 FCC 2d 308, 334 (1979); PanAmSat Corp. v. COMSAT Corp., 12 FCC Rcd 6952, 6957 (1997).

Second, the below-cost pricing scheme theorized by AT&T would present a serious risk of antitrust law violations. Normally, below-cost pricing that has a negative effect on competition in a relevant market is unlawful predatory pricing under Section 2 of the Sherman Act (15 U.S.C. § 2). See Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 117 (1986). The Supreme Court has held that a case of unlawful predatory pricing is made out by proof that the prices complained of are below an appropriate measure of cost, and that the defendant had a reasonable prospect of recouping its investment in below-cost prices. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993). Both the Antitrust Division of the Department of Justice and the FTC have shown a willingness to prosecute cases of predatory pricing. See Remarks of Roger W. Fones of the Antitrust Division before the ABA, "Predation in the Airline Industry" (June 12, 1997); International Telephone and Telegraph Corp., 104 F.T.C. 280, 423 (1984). Clearly, any carrier who engaged in the misconduct postulated by AT&T would risk running afoul of the U.S. antitrust laws.

B. Lehr Affidavit. The only support AT&T can muster for its argument that U.S. carriers with foreign affiliates will begin doing something now that they have never done before -- namely, engaging in below-cost pricing as resale carriers for the purpose of maximizing settlement revenues for the foreign affiliate -- is the affidavit of Professor Lehr. The analysis in the affidavit relies upon numerous assumptions that are at best unproven or in some cases simply untrue, and therefore cannot be relied upon by the Commission.

(i) Lehr's theory rests on the assumption that the U.S. international services market is perfectly competitive, such that any price reductions are evidence of below-cost pricing, and that retail rates are at TSLRIC levels. This assumption is unreasonable for two reasons. First as noted in Section II.A, the FCC's decisions and reports recognize that the U.S. market is not even close to being fully competitive. Lehr's incorrect assumption about the competitiveness of the U.S. market is central to the intellectual credibility of Lehr's theory -- it is the glue that holds together his price squeeze theory. Even Lehr acknowledges that in the absence of perfection, competition would reduce prices legitimately. Also, Lehr acknowledges that competition introduced by the WTO Basic Telecoms Agreement will greatly undercut his theory. See Lehr Affidavit at 9, 12. By assuming perfect competition, Lehr is able to ignore improperly the negative impact of the resale Section 214 condition in excluding existing and potential carriers who would impose lawful price competition against AT&T's excessive international rates.

Second, it is ridiculous to assume that AT&T's retail rates are based upon TSLRIC, which applies in theory to *wholesale* not *retail* products. Even in a fully competitive market, carriers do not establish retail rates at TSLRIC levels. Lehr's assumption that true retail joint and common costs are negligible or already included in TSLRIC (Lehr Affidavit at 14 n.19) is wrong. E.g., Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 FCC Rcd 15499, 15852 (1996).

(ii) Lehr assumes without support that the reaction of U.S. carriers to a below-cost pricing strategy on a particular international route would be to match the reseller's prices. A more rational response from U.S. carriers would be to maintain pricing continuity on the route while pursuing regulatory and legal sanctions against the resale carrier. If that were to happen, then Lehr's predictions of traffic stimulation would not be correct, and the U.S. foreign-affiliated carrier would not achieve the necessary settlement revenues to justify the below-cost scheme. Foreign carriers obviously are not likely to initiate such a scheme when its success depends upon the decisions of U.S. carriers to match below-cost rates.

In his supplemental statement, Lehr recognizes this key deficiency in his analysis, but nevertheless argues that a carrier still might seek to engage in below-cost pricing in order to capture a larger share of the U.S. market or raise its rivals' costs. See Lehr Suppl. Statement at 3-4. However, as noted above, Lehr's supposition proves too much. His theory would result in the FCC preventing *any* carrier with a foreign affiliate that has market power from entering the U.S. resale market -- regardless of whether the affiliate's settlement rates are at benchmark levels -- to prevent them from engaging in cross-subsidy activity. There would no longer be any reason to impose the resale Section 214 condition proposed by AT&T. Indeed, under Lehr's analysis, it is irrelevant whether the U.S. carrier's foreign affiliate is even in the telecommunications market. Any cross-subsidization activity which is designated to allow the U.S. carrier to capture a larger market share or raise rivals' costs would seem to be objectionable. Perhaps AT&T would prohibit entry to any carrier receiving investments from any non-U.S. interest.

(iii) Lehr assumes that customers will quickly migrate to the foreign-affiliated U.S. resale carrier who implements a below-cost pricing strategy on an affiliated route. That assumption is unsupported and not credible. It is silly to suggest that a business customer will shift its entire account to a resale carrier simply because it offers lower rates on calls to, for example, Bahrain. (At the same time, it is not silly to suggest that a resale carrier whose Section 214 authorizations are revoked will lose business customers, since the carrier will be unable to serve critical routes and thus provide one-stop shopping services to its customers.) Further, many business customers are under contract to their current carriers with monetary penalties for early termination. As a result, Lehr seriously overestimates the market share that the carrier could earn as well as the amount of traffic that would be stimulated by below-cost prices.

(iv) Lehr's worst-case quantitative calculations purport to show that a foreign carrier would achieve net profits of approximately US$15,000 per year on a route characterized by more than a million minutes of traffic through a risky below-cost pricing strategy. Lehr's supplemental statement purports to show that such profits might even be as much as US$40,000. It is irrational to conclude that a foreign carrier would be willing to commit the resources and take the risks inherent in a below-cost pricing strategy for such a trivial monetary gain.

(v) Lehr's calculations hinge upon the assumption that the foreign-affiliated U.S. carrier would quickly achieve a 10% retail market share in the United States through this strategy. Achieving a lower market share would undermine the calculations showing that a carrier could achieve net profits through a below-cost pricing scheme. Lehr does not provide any support for the 10% market share assumption. Lehr does not provide even one example where a resale carrier has achieved a 10% market share on a route. Nor does Lehr recognize that the foreign carrier would have to consider the possibility of not achieving a sufficient market share in its risk analysis as a reason not to engage in a below-cost pricing scheme.

(vi) Lehr assumes that there is only one facilities-based carrier in the foreign country, who would receive 100% of the U.S.-outbound traffic stimulated by the below-cost pricing scheme of the affiliated U.S. resale carrier. However, Lehr's analysis falls apart if there are two or more facilities-based carriers in the foreign country who would share the increased volume of U.S.-outbound traffic. That is true in some countries today, and will be true in all WTO member countries according to their GATS commitments (for most beginning January 1, 1998). Indeed, Lehr concedes that any analytic basis for the proposed resale Section 214 condition would be completely eroded if the WTO Agreement is fully implemented. Lehr Affidavit at 9.

(vii) Lehr assumes that the foreign carrier's resale affiliate will have the same cost structure as AT&T on the affiliated route. That assumption is unsupported and contrary to U.S. industry experience. Few if any U.S. carriers can achieve the economies of scale and scope that AT&T enjoys today with its ubiquitous network, entrenched customer base, and significant traffic volume. Were Lehr to assume more reasonably that the foreign-affiliated carrier has significantly higher unit costs than AT&T, the putative "net profits" from the below-cost pricing scenario would be reduced or disappear.

(viii) Lehr assumes that the TSLRIC for terminating U.S.-outbound traffic in foreign countries is $.10/minute or less, and that any settlement revenues received by the foreign carrier at a higher rate would be used "to pursue anticompetitive strategies in the US." Lehr Affidavit at 9 and 14. There is no credible means of determining the purpose to which foreign carriers put the revenues they obtain from international settlements. Furthermore, Lehr provides no basis for the $.10/minute assumption. In the Settlement Rate Decision, the FCC initially concluded that a foreign carrier's termination costs were approximately $.09/minute, but the FCC discarded that analysis when it adopted final rules. In footnote 122, the FCC conceded that "[t]here is no record evidence" to support the $.09/minute estimate. The record in IB Docket No. 96-261 proves beyond doubt that termination costs vary significantly from one country to another, and the FCC has conceded that costs vary among countries.

(ix) Lehr implicitly assumes that U.S. carriers with foreign affiliates could engage in below-cost pricing on all affiliated routes, regardless of the overall level of traffic to the country of affiliation. Yet the fact remains that on some routes -- most notably developing countries -- traffic is insufficient to allow the foreign affiliate to engage in the misconduct envisioned by Lehr. The FCC itself recognizes that where traffic on a route is de minimus, there is no realistic possibility of anticompetitive behavior. See BT/MCI at ¶ 214, n.304 and ¶¶ 290-91 (Gibraltar is not subject to the effective competitive opportunities test and MCI will not be dominant on U.S.-Gibraltar route, despite the fact that BT controls the monopoly provider of international telecommunications services in Gibraltar, because total U.S.-billed minutes to Gibraltar is de minimus).

C. Resale Precedent. The FCC's proposal to condition resale Section 214 authorizations on compliance with benchmark rates is inconsistent with its long-held policies. The Commission has consistently and repeatedly found through the years that the resale of switched services presents no substantial possibility of anticompetitive effects, even on routes where the reseller is affiliated with a foreign carrier that has market power in the destination market, so long as the reseller is not affiliated with the underlying U.S. facilities-based service provider. See, e.g., Regulation of International Common Carrier Services, Report and Order, 7 FCC Rcd 7331, 7335 (1992) ("International Services"); Market Entry and Regulation of Foreign-Affiliated Entities, Notice of Proposed Rulemaking, 10 FCC Rcd 4844, ¶ 72 (1995) ("we do not believe there is a need to regulate foreign carrier entry into the U.S. market for resale services as closely as we propose for facilities-based services [as] there is not as substantial a risk of anticompetitive harm to the global market when we allow foreign carriers into the U.S. international resale market") ("Foreign Carrier Market Entry NPRM"); Foreign Carrier Market Entry Order, 11 FCC Rcd at 3927 ("We continue to consider it unlikely that a foreign carrier reseller would engage in discriminatory conduct...). Indeed, the Commission recognizes in the NPRM in this proceeding that resale presents no significant anticompetitive concerns. Foreign Participation Notice at ¶ 31 ("We continue to believe that the resale of international switched services by a U.S. carrier whose foreign affiliation has market power in the destination country does not present a substantial possibility of anticompetitive conduct in the U.S. international services market").

The Commission's policies on resale carriers reflect these views. The FCC has held that the public interest is best served by granting all carriers, whether U.S. or foreign-affiliated, resale Section 214 authorizations. Thus, the Commission has granted many resale authorizations to foreign-affiliated U.S. carriers, specifically noting that such authority raises no concerns about anticompetitive effects. See, e.g., Cable & Wireless, Inc., 9 FCC Rcd 7283, 7284 (1994) ("We have granted many authorizations for resale in particular because resellers offer significant benefits to consumers in terms of lower costs and innovative services while raising fewer concerns about anticompetitive conduct...); Progress International LLC, Order, Authorization, and Certificate, DA 97-1431 (rel. July 9, 1997) (service to Mexico); NYNEX Long Distance Co., Order, Authorization, and Certificate, DA 97-504 (rel. March 12, 1997) (service to Gibraltar); WorldQuest Networks, Inc., 12 FCC Rcd 4918 (1997) (service to Sri Lanka). The FCC has expressly rejected previous requests by

U.S. carriers to condition the resale Section 214 authorizations of foreign-affiliated U.S. carriers on reduced settlement rates. See Foreign Carrier Market Entry Order, 11 FCC Rcd at 3930.

Furthermore, the Commission's streamlined processes and rebuttable presumptions accorded resellers are also generally available to applicants affiliated with foreign carriers. Thus, applicants that propose to provide resale services on affiliated routes, including routes on which the affiliate has market power, are entitled to a presumption of nondominant treatment, as long as they are not reselling the facilities-based services of an affiliated U.S. carrier. See 47 C.F.R. § 63.10(a)(4); International Services, 7 FCC Rcd at 7335. Indeed, the FCC proposes in this proceeding to extend streamlined processing to the Section 214 applications of carriers who are affiliated with a facilities-based carrier from a WTO Member country where the applicant requests authority to serve that country solely by reselling the switched services of unaffiliated U.S. international carriers. The Commission notes that "streamlined processing is warranted in such a case because, as we have previously found, pure switched resale presents no substantial risk of a foreign carrier leveraging its market power into the U.S. international services market." Foreign Participation Notice at ¶ 134, citing International Services, 7 FCC Rcd at 7334 and Foreign Carrier Market Entry Order at 3292.

The Commission cannot now reverse these longstanding policies without first noting that the old policies are being reversed, and then providing a persuasive justification for the need to do so. As the Supreme Court stated, there is a presumption against "changes in current policy that are not justified by the rulemaking record" (emphasis supplied). Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29, 42 (1983). Here, since the rulemaking record is devoid of justification for imposing the resale 214 condition, the Commission cannot meet the State Farm burden.

D. Overbroad Condition. The condition proposed by AT&T is far broader than necessary to address the harm theorized by AT&T. In the Settlement Rate Decision, the FCC adopted specific policies to deal with any below-cost pricing by foreign-affiliated facilities-based carriers. While the C&W companies believe that such policies are not necessary, they show that the FCC can address below-cost pricing directly when the FCC believes it is necessary to do so. If the FCC is determined to impose a condition to prevent below-cost pricing by resale carriers, it should adopt a condition that states so directly. It is overbroad for the FCC to exclude a U.S. carrier from the resale market altogether due to its foreign affiliate's above-benchmark rates which will not necessarily lead to the behavior which the FCC desires to prevent.

Further, compliance with the FCC's benchmark rates for notional settlement rates has only an indirect relationship to the actual unit settlement rates paid by U.S. carriers. The distinction between notional and unit settlement rates is well established. Lehr Affidavit at 19; Lehr Supplemental Showing at 6 and n.8. The notional settlement rate is what U.S. carriers effectively pay on the traffic imbalance on a route. By contrast, the unit settlement rate is the effective amount that the U.S. carriers pay for the entire stream of U.S.-billed traffic, which is determined by dividing total settlement payments by total U.S.-billed minutes. (For example, suppose that U.S. carriers send 10 million minutes to a foreign country, and the foreign country sends 7.5 million minutes to the United States, at a settlement rate of $.20/minute. The U.S. carriers would make net settlement payments to the foreign country totalling $500,000. Spread over all 10 million U.S.-billed minutes, the unit settlement costs of U.S. carriers on the route would be $.05/minute.) In that situation, the condition proposed by AT&T would not be satisfied, and the foreign-affiliated U.S. carrier would lose it resale Section 214 authorization even though net settlement rates on the route effectively preclude even the theoretical possibility of the price squeeze activity AT&T claims to fear. In these cases, it would be unreasonable for the FCC to exclude a carrier from the U.S. market serving a route just because the notional settlement rate is above the benchmark.

V. THE RESALE SECTION 214 CONDITION WOULD VIOLATE THE WTO AGREEMENT, WOULD CONTRAVENE THE EQUAL PROTECTION PROVISIONS OF THE FIFTH AMENDMENT, AND WOULD BE INCONSISTENT WITH OTHER FCC POLICIES.

A. <u>WTO/GATS</u>. The proposed resale Section 214 condition would place the United States in violation of the WTO Basic Telecoms Agreement and the GATS Agreement to which it is a protocol. First, such a condition is a pre-entry restriction in violation of the Market Access commitment in GATS Article XVI. That market access violation is not overcome by any plausible theory of appropriate competitive safeguards, particularly if other countries comply with their obligations under the Reference Paper. Second, the condition would violate the requirement in GATS Article VI because it is wholly disproportionate in severity to the underlying "problem" it purports to address. The condition would discourage foreign entry and destroy the ability of existing U.S. carriers with foreign affiliates to compete in the U.S. market. Yet as shown in Section I and IV above, the misconduct hypothesized by AT&T has never been shown to have occurred, is not likely to occur in the future, and could be readily detected if engaged in by a U.S. carrier with a foreign affiliate. Third, the condition discriminates among foreign carriers based upon settlement rates in violation of the Most Favoured Nation principle in GATS Article II. Fourth, the condition discriminates in favor of U.S. carriers in violation of the National Treatment principle in GATS Article XVII. The FCC must analyze the WTO implications of AT&T's proposal as part of its application of the public interest standard. In doing so, the Commission must recognize that the failure of the U.S. to comply with its obligations under the WTO Basic Telecom Agreement may prompt other countries to restrict the entry of U.S. carriers into their markets, thereby further reducing competition in the market for international services.

B. Internal Inconsistency. The FCC should not adopt AT&T's proposed resale Section 214 condition because it would be inconsistent with other FCC policies. Both AT&T and the FCC agree that domestic interstate access charges are significantly above cost. See AT&T Comments at 28 and n.45-46 (noting that U.S. domestic interstate access charges are 700% higher than economic costs); Settlement Rates Decision at ¶ 214 ("we have taken, and continue to take, action to ensure that the incumbent LEC access rates continue to move toward the underlying cost of providing access services"); Access Charge Reform at ¶ 43. The FCC's relatively lenient treatment of above-cost access charges repudiates any adoption of AT&T's proposed resale Section 214 condition.

First, the FCC has now provided explicit guidance to the Bell companies in two decisions regarding the steps they must take to comply with the Section 271 checklist requirements before they may enter the in-region interLATA market. See Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Michigan, FCC 97-298, rel. August 19, 1997; Application of SBC Communications, Inc. Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Oklahoma, 12 FCC Rcd 8685 (1997). In neither decision has the FCC stated that a Bell company must reduce its access rates to cost-based levels as a condition of entering the in-region interLATA market. That permissive policy is flatly inconsistent with AT&T's proposal that foreign carriers reduce their settlement rates to benchmark levels before entering the U.S. international resale market.

Second, AT&T's theory applies equally to the provision of long distance and international services by any incumbent LEC. With access charges well above cost today and for at least the near future, AT&T's theory would hold that incumbent LECs have the incentive and ability to price domestic long distance services at below-cost levels simply to maximize intrastate and interstate access charge revenues. E.g., Lehr Affidavit at 19-20 (noting that above-cost access charges are analogous to above-cost settlement rates). Therefore, if the FCC adopts the proposed resale Section 214 condition, it must adopt a similar condition whereby incumbent LECs cannot provide long distance or international services until they reduce intrastate and interstate access rates to cost-based levels.

Finally, application of the proposed resale Section 214 condition would be inconsistent with the concerns expressed by the Commission in the Foreign Participation Notice for the needs of developing countries. To address the concerns of developing countries about the impact of accounting rate reductions on telecommunications network development, the FCC adopted a transition plan that gives developing countries additional time to transition to benchmarks. Foreign Participation Notice at ¶ 166. Yet, adoption of the proposed resale Section 214 condition would compress that transition period to a mere 90 days for foreign affiliates from developing countries.

C. Equal Protection. The FCC's decision to regulate U.S. ILECs more leniently than foreign carriers in similar circumstances violates the Equal Protection requirements of the Fifth Amendment of the U.S. Constitution. It is well-established that "classifications based on alienage, like those based on nationality or race, are inherently suspect and subject to close judicial scrutiny." Graham v. Richardson, 402 U.S. 365, 371-72 (1971). Further, corporations qualify as "persons" who are entitled to full Fifth Amendment protection. E.g., Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869 (1985); Grosjean v. American Press Co., 297 U.S. 233 (1936). Further, as an existing, authorized U.S. international carrier, CWI plainly has sufficient contacts with the United States to qualify for protection under the Fifth Amendment. E.g., United States v. Verdugo-Urquidez, 494 U.S. 259, 271 (1990). The adoption of a resale Section 214 condition under the circumstances outlined in this document, coupled with the FCC's more lenient treatment of U.S. incumbent LECs in nearly identical situations, does not come close to satisfying the strict scrutiny standard. The proposed Section 214 condition does not even arguably fall within the exemption to strict scrutiny for classifications created by Congress or the Executive Branch pursuant to their Constitutional authority over immigration and foreign affairs. E.g., Matthews v. Diaz, 426 U.S. 67 (1975).

VI. *ADOPTION OF THE RESALE SECTION 214 CONDITION WOULD BE UNLAWFUL BECAUSE THE BENCHMARK RATES ARE UNLAWFUL AND NOTICE IS INADEQUATE.*

A. Lawfulness of Settlement Rates. Conditioning resale Section 214 authorizations on compliance with the benchmark settlement rates would be unlawful because the benchmarks themselves are unlawful. As C&W plc argued in its comments and reply comments in IB Docket No. 96-261, the FCC does not have the legal jurisdiction, either under the Communications Act, U.S. treaties, or international law, to prescribe rates a foreign carrier charges consumers within its own country. Further, the record in IB Docket No. 96-261 amply demonstrates that the FCC lacks the data on foreign carriers' costs that is necessary for a rate prescription. As such, any license condition based on the FCC's benchmark settlement rates would be arbitrary and capricious. The lawfulness of the Commission's benchmark settlement rates are currently on appeal in Cable & Wireless plc, No. 97-1612 (D.C. Cir. filed Sept. 26, 1997) and consolidated cases.

B. Adequate Notice. The FCC has not provided adequate notice of the possibility of conditioning existing Section 214 resale authorizations on accelerated compliance by foreign affiliates with the benchmark settlement rates.

(i) The Foreign Participation Notice contained no suggestion that the Commission was considering imposing conditions on any Section 214 resale authorizations. Instead, the NPRM made clear that the FCC intended to "impose specific and significant sanctions on foreign-affiliated carriers that engage in anticompetitive conduct in the U.S. market." Foreign Participation Notice at ¶ 81 (emphasis added).

(ii) In response to the Foreign Participation Notice, AT&T's comments suggested requiring compliance with the benchmark settlement rates as a condition of resale Section 214 authorizations granted on or after December 19, 1996 to U.S. carriers with foreign affiliates. See AT&T Comments at 33, n.60 and 46. In the Settlement Rate Decision, the FCC called attention to the AT&T comment and observed that the issue would be better addressed in the Foreign Participation proceeding. The FCC also observed that "parties will have an opportunity to comment in their reply comments" to the Foreign Participation Notice. See Settlement Rate Decision at ¶ 230. In fact, however, parties did not have an opportunity to reply to AT&T's comment in light of the

Settlement Rate Decision, because the Settlement Rate Decision was issued on August 18, 1997, several days after the close of the reply comment period in the Foreign Participation Notice. More importantly, the C&W companies had no reason to respond to AT&T's comment because AT&T clearly sought conditions on new, not existing, Section 214 authorizations. Since CWI holds existing resale authorizations, the AT&T proposal would not apply to these authorizations.

(iii) In the absence of adequate notice that the FCC is considering placing conditions on existing resale authorizations, and in the absence of any FCC analysis of the profound adverse effect on competition that would result from placing conditions on existing resale authorizations, the FCC cannot lawfully include such conditions on existing resale authorizations in the forthcoming report and order in the Foreign Participation proceeding. The filing of this ex parte statement does not remedy the Commission's notice problem. The fact that one party files comments does not mean that all relevant parties have notice. See MCI Telecommunications Corp. v. FCC, 57 F.3rd 1136, 1141 (D.C. Cir. 1995); American Federation of Labor v. Donovan, 757 F.2d 330, 339-340 (D.C. Cir. 1985).

VII. ADOPTING AT&T'S PROPOSED RESALE SECTION 214 CONDITION WOULD BE AN UNAUTHORIZED TAKING.

A. CWI'S Property Interest. The FCC may not adopt a regulation that predicates the continued validity of Section 214 authorizations on the conformance of a foreign carrier's settlement rates to FCC benchmarks because such an action would constitute an unlawful taking under the Fifth Amendment. The rights inherent in resale Section 214 authorizations held by CWI are private property interests protected by the Fifth Amendment's prohibition of governmental taking without just compensation. It has been held that governmental licenses to pursue lines of business qualify as "private property" for the purposes of the taking clause of the Fifth Amendment. See, e.g., Jackson v. United States, 103 F.Supp. 1019 (Ct. Cl. 1952) (federal government abrogation of state commercial fishing license); see also Shanbaum v. United States, 1 Cl. Ct. 177 (1982), aff'd 723 F.2d 69 (Fed. Cir. 1982) (loss of Title III broadcasting license could justify takings claim). See also In re Beach Television Partners, 38 F.3d 535 (11th Cir. 1994); Orange Park Florida T.V., Inc. v. FCC, 811 F.2d 664, 674 n.19 (D.C. Cir. 1987).